STATEMENT FOR THE RECORD

SUBMITTED TO THE

HOUSE COMMITTEE ON WAYS & MEANS
SUBCOMMITTEE ON SOCIAL SECURITY

On

Chained Consumer Price Index

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Introduction

As the largest nonprofit, nonpartisan organization representing the interests of Americans age 50 and older and their families, AARP greatly appreciates the opportunity to discuss in this testimony the important role Social Security plays, and will continue to play, in the lives of current and future generations of Americans and AARP's specific concerns regarding cuts to Social Security via the adoption of what is known as the chained consumer price index (CPI).

Social Security Benefits are Vital But Modest

Social Security is the only lifetime, inflation-protected, guaranteed source of retirement income that most Americans will have. It is the foundation of retirement security that keeps millions of older Americans out of poverty and allows them to live independently. But Social Security also provides some measure of economic security for families who face a loss of income because of the disability or the death of a wage earner. The inflation protection provided through Social Security's annual COLAs is a critical component to the success of the program.

At the end of 2012, about 57 million people received benefits from Social Security. The majority of these beneficiaries were 36.7 million retired workers. Social Security beneficiaries, however, also included 8.8 million disabled workers, 4.4 million children, 4.3 million widows, widowers, and parents and 2.4 million spouses.[1] For many of these beneficiaries and their families, Social Security is the one source of income that stands between them and poverty – without it, more than 21 million additional men, women and children would be in poverty.[2]

Today, half of those 65 and older have annual incomes below $20,000, and many older Americans have experienced recent and significant losses in retirement savings, pensions, and home values. Every dollar of the average Social Security retirement benefit of a little over $15,000 is absolutely critical to the typical beneficiary. For older American households receiving benefits, Social Security is the principal source of income for nearly two-thirds, and roughly one third of these households depend on Social Security for nearly all of their income.[3] Reliance on Social Security as a source of guaranteed income only increases as people age.[4]

Social Security benefits are particularly important for women, who, on average, live longer and earn less than men. Women also spend more time out of the labor force or work part-time to care for children and other family members. Fifty two percent of all women aged 65 and older depend on Social Security benefits for 50 percent or more of their family income. Moreover, in 2011, older minorities relied on Social Security for a significant share of family income. Thirty-four percent of African Americans and 35 percent

[1] Data accessed from: http://www.ssa.gov/cgi-bin/currentpay.cgi
[2] Center on Budget and Policy Priorities, Social Security Keeps 21 Million Americans Out of Poverty: A State-by-State Analysis, available at http://www.cbpp.org/cms/?fa=view&id=3851.
[3] Social Security Administration, Income of the Population 55 or Older, 2010, available at Table 9.A1 http://www.ssa.gov/policy/docs/statcomps/income_pop55/2010/sect09.html.
[4] Social Security: Who's Counting on It, page 2, AARP Public Policy Institute

of Hispanics who are 65 and older depended on Social Security for 90 percent or more of their family income. Finally, the poor and near-poor also rely on Social Security for a significant share of their income; in 2011, more than half of the poor and almost 50 percent of the near-poor relied on Social Security for 90 percent of more of their family income.

And Social Security will likely be even more important to future generations. Due to stagnating income, escalating personal debt and rising costs for education and health care, workers today are less likely than their parents or grandparents to enjoy the living standards of their working years when they retire. If these trends continue, Social Security will be the main source of income for all but the wealthiest retirees in the future.

The Chained CPI is NOT More Accurate for Retirees or the Disabled

Social Security contains several programmatic features that pertain to inflation and are designed to ensure that retirees maintain some modicum of their pre-retirement standard of living. First, when calculating one's initial benefit, Social Security looks at an individual's entire earnings history and then translates prior wage levels into present-day dollars, otherwise known as wage indexing. According to Social Security, "such indexation ensures that a worker's future benefits reflect the general rise in the standard of living that occurred during his or her working lifetime."

Once a retiree begins collecting Social Security, their benefit is adjusted annually to account for price inflation. This is to ensure that a beneficiary maintains the purchasing power of the benefits he or she has earned and the beneficiary's standard of living does not erode over time. That annual inflation adjustment, known as a cost-of-living adjustment (COLA), gets added to the previous year's benefit amount, and becomes part of the base benefit on which next year's COLA is computed.

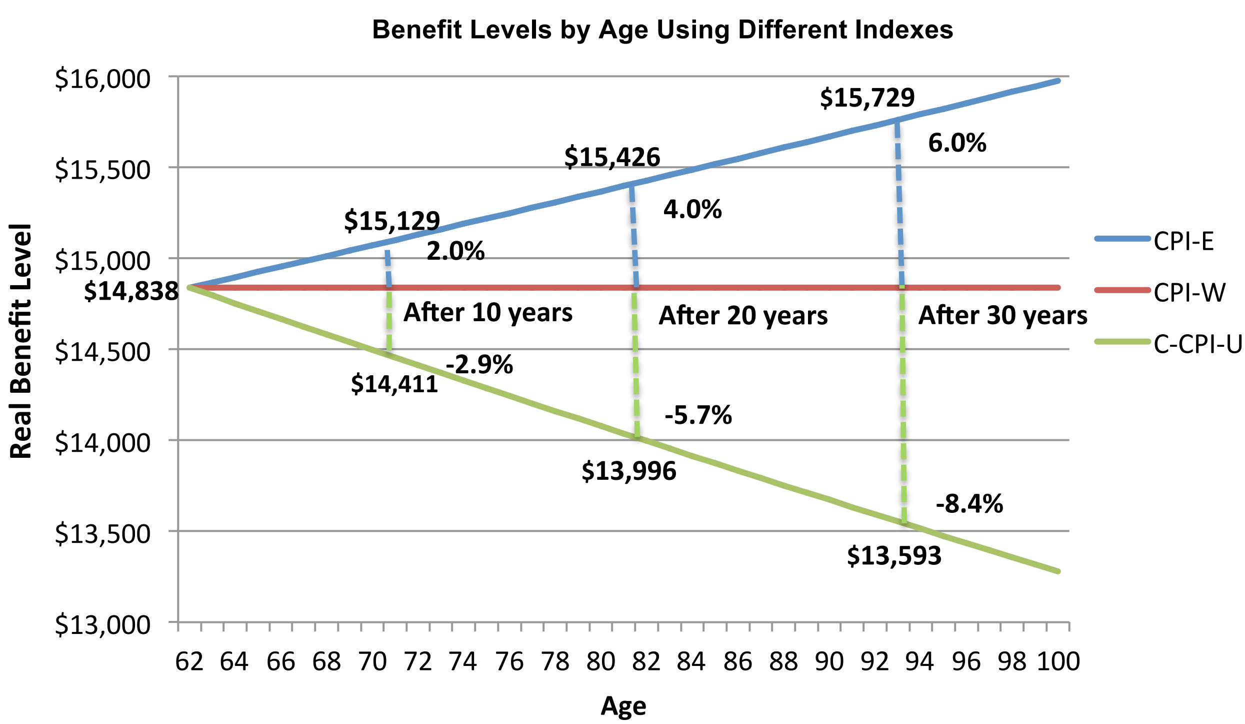
Despite claims to the contrary, the <u>chained CPI is *NOT* a more accurate measure of inflation, *especially* for Social Security COLAs.</u> <u>In fact, it is even *less* accurate than the current formula.</u>

Currently, the COLA is calculated using the Consumer Price Index for Urban Wage Earners and Clerical workers, otherwise known as the CPI-W. By definition, this index reflects the purchasing patterns of those Americans who are still in the workforce. However, retirees and those out of the workforce due to disability have different spending patterns. Retirees and the disabled spend much more on medical care than working Americans. Moreover, health care costs have risen much faster than inflation in the prices for other goods and services. But because the current CPI-W formula is based on the spending patterns of *workers*, not *retirees*, current COLAs are based on an index that already underreports the real cost of inflation experienced by seniors. As such, the current COLA is already lower-than-warranted for seniors and those who cannot work due to disability.

Another flaw with the accuracy claim is that the chained CPI is premised on substitution behavior by consumers that, for several reasons, may not significantly occur among older or disabled Americans. First, these Americans typically live on less income than they did when employed, and thus most have already "traded down" or substituted where possible to save money, such as purchasing generic instead of name-brand drugs. Second, older Americans tend to spend more of their income on expenses for which little or no substitution is available. Healthcare expenses (including drugs), housing, and utilities make up a substantial portion of an older or disabled person's spending. For expenses like these, the only option may be going without; no further substitutions are possible without significantly diminishing the ability of a retiree to maintain a decent standard of living. Reducing annual COLAs under the premise that older and disabled Americans can make these further substitutions will only undermine their ability to maintain their already modest standard of living – defeating the purpose of ensuring that the value of Social Security benefits are not eroded by inflation.

If accuracy is the goal, as some have argued to justify the adoption of chained CPI, then the first step should be to properly calculate the market basket of goods that are purchased by retirees and the disabled. The Bureau of Labor Statistics constructed an experimental index (the CPI-E) that better reflects the consumption patterns of people age 62 and over. Not surprisingly, this index shows that the rate of inflation for those 62 and over has been higher than the rate measured by the CPI-W in most years.

The inaccuracy of moving to a chained CPI, and its true impact on beneficiaries should therefore not simply be measured by the size of the cut relative to the CPI-W, but to the more accurate CPI-E. The Social Security Administration has estimated that the difference in growth between the CPI-E and the chained CPI could be as much as one half a percentage point each year. (See table below.)



Source: AARP Public Policy Institute

AARP believes that to the extent Congress is searching for a more accurate measure of inflation for annual COLAs, Congress should adopt a measure that accounts for the spending patterns of older Americans. The chained CPI fails this test and would further underreport the inflation experienced by retirees and the disabled and thus erode their standard of living.

The Chained CPI is a Significant Benefit Cut

Although many have attempted to characterize the chained CPI as a minor tweak, it is in fact a *significant benefit cut* that snowballs over time. The adoption of chained CPI would take approximately $340 billion dollars out of the pockets of current and near retirees, working families, veterans and the disabled, as well as the local economies in which they live, in the next 10 years alone. Specific to Social Security, the chained CPI cuts benefits by $127 billion over the next 10 years.

Initially, the 0.3 percent annual cut in Social Security COLAs exacted by a chained CPI may look small, but it compounds over time. The greatest impact of the COLA cut will be on those who receive benefits over a long period of time; the oldest retires and the long-term disabled. According to the National Women's Law Center, "(f)or an individual who receives a monthly benefit of $1,100 per month at age 65, the chained CPI would reduce benefits by $56 per month ($672 annually) at age 80," which is equivalent to losing one week's worth of food each month.[5] The chained CPI would cut one full month's income each year from a 92-year-old beneficiary's annual Social Security benefits.

AARP is greatly concerned that the oldest can least afford a COLA cut as reliance on Social Security as a source of guaranteed income only increases as people age. Americans in their 80s and 90s generally have less income, fewer financial assets, and are more dependent on Social Security than younger beneficiaries. They also face increasing out-of-pocket medical costs and are at greatest risk of poverty.

The impact of chained CPI would also disproportionately hurt women and the poor. Women tend to live longer than men and make up a larger share of the population as it ages. Because of their longer life expectancies, women would be subject to the compounding cuts of chained CPI for longer. Women also tend to have lower incomes, are more dependent on Social Security, and are more at risk of falling into poverty. The chained CPI will also cut living standards most deeply for the poorest households, who tend to rely on Social Security for all or most of their income.

Moreover, the chained CPI would cut the benefits of more than 3.2 million disabled veterans in this country and another 2 million military retirees. Under the chained CPI, permanently disabled veterans who started receiving disability benefits at age 30 would see their benefits cut by more than $1,400 a year at age 45, $2,300 a year at age 55 and $3,200 a year at age 65.

[5] National Women's Law Center, Switching to the Chained CPI Means Painful Cuts to Social Security Benefits - Especially for Women 2 (Oct. 2012), available at http://www.nwlc.org/sites/default/files/pdfs/socialsecuritychainedcpiupdate.pdf.

Finally, low- to moderate-income households will also get a sizable tax increase thanks to the chained CPI by reducing the annual adjustment made to many parameters in the tax code. Over 10 years, chained CPI results in a $123 billion tax increase, the impact of which will be felt most by those of modest incomes. According to an analysis by the Joint Committee on Taxation, by 2021, taxpayers making between $10,000 and $20,000 would see a 14.5 percent increase in their federal taxes under a chained CPI.

President's Mitigation Efforts Fall Short

In recognition of the fact that chained CPI would significantly erode the standard of living for millions of retirees, the disabled, veterans and the poor, the President's FY2014 Budget attempts to shield certain "vulnerable" populations from chained CPI's harmful effects. The President proposes to provide a small 5 percent benefit bump-up phased in over 10 years from ages 76 to 85 and another bump from ages 95 to 104. He also proposes to mitigate for the very poor by exempting means-tested programs. The President's mitigation proposals fail because they don't protect everyone who needs protection and even fail to adequately protect the very old and the very poor in some cases.

The President's mitigation proposals do not exempt those who receive Social Security retirement benefits. Instead, these beneficiaries are to receive two "bumps" in their benefits after enduring decades of diminished COLAs. Vulnerable individuals would therefore see no help from the President's proposals unless and until they turn 76. According to the Social Security Administration's mortality tables, of the persons who reached age 62 and became eligible for Social Security retirement benefits, about three quarters would live long enough to *start* to receive the first benefit bump-up that begins at age 76, but only about half would survive through age 85, the end of the ten-year phase-in of the benefit enhancement. Only about 10% would still be alive at age 95 to begin the second 10-year benefit bump-up, and a negligible number of these beneficiaries would live out the second phase-in of the benefit enhancement, which finishes at age 104. Nor do the President's mitigation proposals exempt those on Social Security disability. They too would have to endure years of COLAs that do not keep up with the inflation they experience before receiving minimal bonuses.

Remarkably, the President's mitigation proposals do not exempt veterans, both retired and disabled. Many veterans depend on monthly benefits from retirement or disability compensation, both of which receive annual COLAs that would be reduced by a switch to the chained CPI. And veterans are often eligible for these benefits at younger ages than for Social Security and could experience the compounded cuts to benefits over many decades. It is also important to note that over 9 million veterans receive both Social Security and veteran's benefits and would be hit by the chained CPI twice.

As noted above, the President proposes to protect the vulnerable poor by exempting means tested programs. However, exempting means tested programs is not equivalent to exempting the poor. For instance, millions of low-income retirees depend almost solely on their Social Security benefits but do not qualify for means tested programs like Supplemental Security Income (SSI). These individuals would not be protected by the President's proposals. AARP is uncertain how many of these individuals might fall into poverty as a result of the chained CPI. There are also low-income retirees who receive both SSI and Social Security. The Social Security portion of their income is not exempt from chained CPI. Finally, AARP notes there is nothing in the President's mitigation proposals to protect low- to moderate-income households from the sizable tax increase they will face as a result of chained CPI.

The American People Overwhelmingly Oppose Chained CPI

Older Americans truly understand that budgets matter and that we all need to live within our means. But they also understand that budgets impact real people – federal programs can make meaningful differences in peoples' lives and help ensure that older and disabled Americans can live independently and with dignity as they age. They also understand the difference between programs that have been contributed to and earned over the course of a lifetime of work and those that are not.

In March 2013, AARP commissioned a national survey that examined older voters' opinions on a proposal to adopt a chained CPI to reduce the deficit. AARP's survey also looked at how favorability would be affected towards Members of Congress who voted for such a proposal.

- The poll found older voters are nearly unanimous in their belief that Social Security benefits should not be reduced for today's seniors, with 87 percent saying the issue is "very important" to them (89 percent Democrat, 86 percent Republican, 88 percent Independent).

- Similarly lopsided margins of older voters believe that Social Security should be "off the table" in the current budget debate. Across party lines, a large majority of 50+ voters (84 percent) oppose reducing Social Security benefits in order to reduce the deficit (91 percent Democrat, 80 percent Republican, 78 percent Independent). In fact, 73 percent *strongly* oppose.

- 84 percent of older voters said that the future of the retirement security program should be considered separately and political affiliation made barely any difference.

- Of those surveyed, 70 percent said they oppose using a chained CPI for Social Security (75 percent Democrat, 63 percent Republican, 69 percent Independent).

- And 78 percent said they oppose using a chained CPI for retired and disabled veterans' benefits. (80 percent Democrat, 72 percent Republican, 79 percent Independent).

- In addition, 52 percent of those surveyed said they oppose using a chained CPI to adjust the tax code for inflation and 34 percent said they support that idea (13 percent said they didn't know and 1 percent declined to answer).

The older voters surveyed, who were split almost equally among Democrats, Republicans and independents, also sounded a strong note for Capitol Hill lawmakers who might support a switch to the chained CPI.

- Two-thirds (66 percent) said they would have less favorable feelings toward their representative in Congress for voting in support of chained CPI (69 percent Democrat, 60 percent Republican, 67 percent Independent).

These survey results align with the information AARP has been gathering from the public through our You've Earned a Say initiative over the past year. AARP members and older Americans recognize that Social Security did not cause our federal deficits and, therefore, the much-needed benefits of real, hardworking people should not be cut in order to remedy the deficit.

Social Security is Not a Deficit Driver

Social Security benefits are financed through payroll contributions from employees and their employers, throughout an individual's working life. The payroll contributions and benefits paid, including any administrative costs, are accounted for separately from the rest of the federal budget.

Further, by law, Social Security cannot pay out more in benefits (including administrative costs) than it has taken in over the life of the program. That is, the program has no statutory authority to borrow to pay benefits. Once the trust fund is exhausted, Social Security can only pay benefits to the extent it receives revenue from payroll contributions. As such, Social Security has not contributed to our large deficits.

To the contrary, Social Security has had cash surpluses each year for most of the past 30 years, taking in more revenue than it needed to pay in benefits. These surpluses, generated by the payroll contributions made by the American people, have been borrowed to meet other expenses of the federal government. In exchange, the federal government has issued Social Security Treasury bonds of equal value. That is, Social Security has reduced the past need for additional government borrowing from the public and resulted in a publicly held debt that is less today than what it otherwise would have been.

Social Security Deserves Its Own Conversation

AARP believes that reducing the nation's deficit and restoring confidence in our budget is important, but we also understand that Social Security is vital to the economic security of older Americans and the disabled; it has a dedicated funding source, is a separate and self-financed program, and did not add to our federal deficit. Therefore, AARP believes that cuts to the program should not be made to reduce the deficit.

According to the Social Security Trustees, even with no changes at all, Social Security has sufficient income from payroll contributions and assets in Treasury notes to pay 100 percent of promised benefits for the next 20 years, and can continue to pay approximately 75 percent of promised benefits thereafter. Social Security is therefore not in crisis, but the projected gap should be closed.

AARP believes that the current Social Security funding shortfall should be addressed sooner rather than later so that the fundamental structure of the program can be retained and the protections it offers to almost all workers and their families can be protected and even enhanced. However, any such changes to the Social Security system must be made within the proper framework of increasing the retirement security of real people and protecting current beneficiaries who have paid into the program during their working lives. The chained CPI does neither.

In the face of declining pensions, shrinking savings, stagnating wages, and rising health costs, Social Security deserves its own national conversation that focuses on preserving and strengthening the retirement security of Americans and their families for generations to come. AARP welcomes that conversation and stands at the ready to engage with Congress, our members and other Americans on ways to strengthen Social Security now and in the future.

Conclusion

The promise of Social Security has endured for over 75 years. It is a promise that AARP believes embodies our deepest values as Americans – our obligations to one another – our obligations between generations – between parents and children – between grandparents and grandchildren – between those in retirement and those at work – between the able-bodied and the disabled. And AARP firmly believes that this promise must continue to endure as Social Security will continue to play a critical role in the lives of future generations of Americans.

Once again, AARP would like to thank Chairman Johnson and Ranking Member Becerra for the opportunity to share with our views on the important role Social Security plays, and will play, in the lives of both current and future generations of Americans. We look forward to working with you and the other members of this Committee to ensure that any changes to Social Security are done in a way consistent with the needs and wants of the American people.